

***The 2004
Elections And
The Reform Of
Local
Governments –
Analysis,
Forecasts And
Recommendations***

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Who won and who lost the June local elections? What do the results tell us about the national elections to be held in November this year? What are the strengths and weaknesses of the ruling party and the opposition alliance? How should the local governments be reformed in order to function well, irrespective of who wins elections? All these, and more, in this issue of PWR. The final sections analyzes the Romanian telecom market from the perspective of EU accession.

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SAR was proved right

LOCAL ELECTIONS SHOWED THAT ROMANIANS WANT A MAJOR POLITICAL CHANGE IN 2004

However, the PSD has distorted and will further distort the will of the electorate by abusing its power

Local elections in Romania have always created confusion. This allowed the PSD to claim victory in every election held after 1989 (even when it was still called PDSR, FSN, etc). However, these victories were always controversial because PSD never managed to win the most important cities and county councils. Real politics typically began only after elections, when Mr. Cozmăncă (former Minister of Administration, current deputy president of PSD) would have his prefects dismiss elected mayors, a practice abandoned just under heavy pressure from the Council of Europe, or recruit mayors through bribe and blackmail (such methods are still largely used; see the biographies of candidates in *The Voter's Guide* issued by the Coalition for a Clean Parliament). There are thus two main issues when we talk about local elections in Romania. One is the ballot itself, i.e. the functioning of elections, the quality of electoral campaigns, the dynamics of the electoral process and the analysis of outcomes. The second topic is, however, at least as important. It concerns democracy and democratic mechanisms. Elections are held so that we can democratically control local government. But can Romanians actually do that? We cast a vote on Sunday, the 6th of June. Was that of any importance? Or is real politics actually pursued through mechanisms other than elections? What can we do to make it worth voting in the next local elections? What can we do in order to convince more than half of the electorate that such elections do make sense, and that those elected are really in power?

TREND

The political section of this SAR report is therefore divided into two parts. In the first part we are going to analyze the outcome of elections and discuss the degree to which we can consider these elections democratic. In the second part we will have a look at the real mechanisms of local power, and the way these mechanisms are distorted by the government through bad practices against a background of unfinished institutional reforms. Both parts formulate recommendations aimed at improving accountability and administrative performance, objectives repeatedly stressed in the Annual Country Reports of the EU Commission.

Who are the actual winners and losers of 2004 local elections ?

Outcomes are split. However, results for county and local councils clearly show that **the PSD did not win the elections**. Anyway, not in those counties where it openly ran as a party, and not under the umbrella of some newly recruited local oligarch (the case of Mazăre, the mayor of Constanța, recruited last year). PSD rather has lost than won. Of course, their position is not that bad when we compare these outcomes with those of the 2000 elections or even of earlier elections. PSD has kept its strongholds in the poor rural regions, where control over resources means control over all the important local players, and thus control over politics. However, defending its old positions was not enough anymore, as the opposition Alliance witnessed a spectacular growth. Let us have a look at the evolution of each party compared to prior elections.

1. **PSD stagnated compared to the 2000 local elections, but lost compared to the Alliance, as well as compared to its own targets.** The PSD finds itself far lower than the 50% it had been scoring in house surveys, and lower than the 40% score in independent polls. At the end of the first round of elections, the PSD was not able to defend its 70% recruited mayors and went back to the 2000 situation of 36% of the mayors. They will most probably still win back some of them in the second round, but it is clear that they will not be able to win in elections what they had managed to conquer through recruitment and political migration in the last years. The PSD had, however, a good performance in terms of local councilors.
2. **The Alliance D.A. was the main winner of the elections**, managing to maximize its performance both compared to the individual performance of the two parties in the 2000 elections and as an alliance of the Opposition. PD has grown from 10% to more than 15%. PNL went from 7% up to 18% (if we split the votes of the Alliance equally and round them down). When we add this to their crushing victory in Bucharest and to the good position of the PD for the second round in certain towns, we may say that the Alliance had a great performance, also managing to overtake the PRM in every aspect. The success they had with joint lists in Bucharest, where they won much more votes than if they had run separately, shows that *the best electoral publicity of the Alliance is its unity* – an idea already stressed by SAR prior to elections. PNL has managed to win back most of the PNTcd's (Christian Democrats) disappointed electorate. PD succeeded in taking away votes from the PRM, the extreme right. The Alliance won back the urban areas by taking away votes both from the PSD and the PRM.
3. **PRM stagnated**, as there was no significant gain compared to 2000 for the ultranationalists. The votes in urban areas went to the Alliance, which was seen as an alternative that stood greater chances of winning elections. The main campaigner of the party, Vadim Tudor, was rather discreet, as he focused on changing his image into a more respectable, mainstream politician, which sent an unclear message to his public. The PRM lost in terms of mayors, as Gh. Funar was defeated in Cluj. Our previous reports had already launched this hypothesis that the constituency of PRM was much more radical than the party itself.
4. **The newly appeared PUR** ("Humanistic party", centrist formation set up by a media mogul) is now on its own feet, thanks to their success in Bacău.

The PSD did not lose in absolute terms, but it lost compared to its own expectations, its competitors and, first of all, compared to its situation at the beginning of 2004

Conclusion: The 5% electoral threshold introduced in 2000 generated a coagulation of the electorate around four main political parties. This explains the growth of these parties compared to 1996, when a lot of votes were wasted on small actors. The raising of the threshold brought along the stabilization of the party system and led to an increased concentration of votes in 2004 compared to 2000. Therefore, the main losers of these elections were small parties, which do not stand any chance in the November ballot.

Fig. 1. The growth of major political parties compared to previous elections

Political Parties	Local elections for County Councils % of votes			
	1996	2000	2004	Growth
PSD (PDSR)	16	27	33	+ 6
PD (within USD)	11	10	13+5/2	+ 6
PNL		7	16+5/2	+ 11
Alliance of the Opposition	20 (CDR)	7 (CDR)	34 (DA)	
PRM	4	7	8	+1
PUR		2	6	+ 4
UDMR	7	6	6	---

All figures higher than 0.5 were rounded up. In the previous report we rounded them down, which has generated endless discussions and protests from the PSD. We therefore warn that the total may now be higher than 100%, as then it was lower than 100%.

Why did these results come as a surprise?

Such outcomes may seem surprising, but they should not be. In the special issue of PWR published in March, SAR's forecast was that the PSD was going to lose around a quarter of its constituency of 40% predicted by the SAR-CURS poll conducted in March. At the same time, one of our questions in the survey showed that 42% of the Romanians believed a political alternative to the PSD already existed, compared to 39% of them, who did not. In other words, there were clear – although indirect – signs that we were heading towards parity between the PSD and the Alliance, with a slight advantage for the latter.

The surprise, if there was any, was a generated by surveys only, especially by those contracted by PSD with IMAS, Minister Teodorescu's company. The difference between Mircea Geoană and Traian Băsescu had been forecasted by this institute as zero (impartial!), while CSOP and CURS had predicted higher margins. The closest survey to elections in terms of timing, the one conducted by Metromedia, which was not made public, gave the best predictions.

CURS and IMAS were the only two institutes, which have constantly surveyed the political preferences of voters at national level. Their predictions differed constantly and significantly with regard to the forecasted performance of the PSD. IMAS (opinion poll ordered by the PSD) granted the PSD around 50% of the votes, while CURS (omnibus political survey co-financed by SAR and a liberal association) was

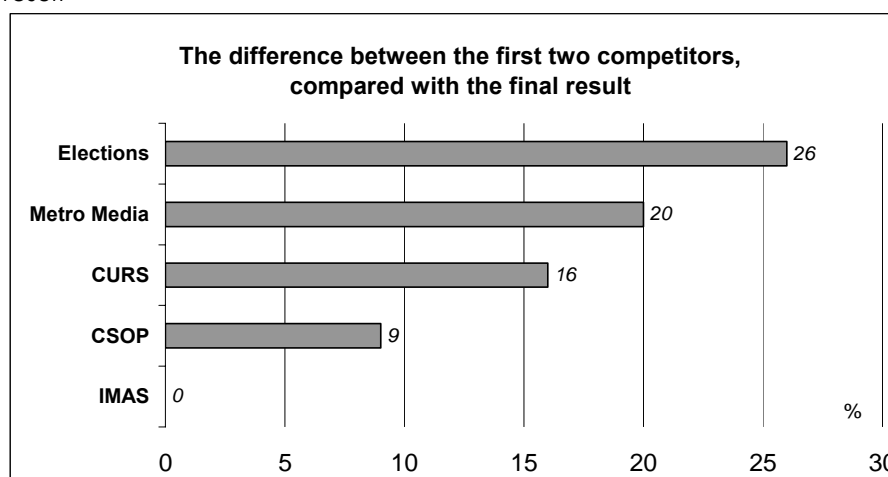
predicting a 40% figure. IMAS' director, Mircea Kivu, has even organized a workshop of a professional association with a pompous name – The Romanian Society for Marketing and Public Opinion (SORMA) – in order to explain us that both results were equally scientific and blamed the methodology for the inconsistency.

“The directors of IMAS and CURS say that Romanians can further trust pre-electoral surveys, even if the results presented by these institutes indicate significantly different percentages for the government party. They denied the allegation that such differences were caused by their party ‘affiliation’ and argued that the real cause for this was the fact that each institute has its own methods of measuring public opinion.”

Cotidianul newspaper, quoting the press conference of Mr Mircea Chivu, IMAS, and Sebastian Lazaroiu, CURS, held in April 2004.

<http://www.cotidianul.ro/anterioare/2004/politica/pol1218apr.htm>

Fig. 2. How close were polls on mayoral elections in Bucharest to the final result



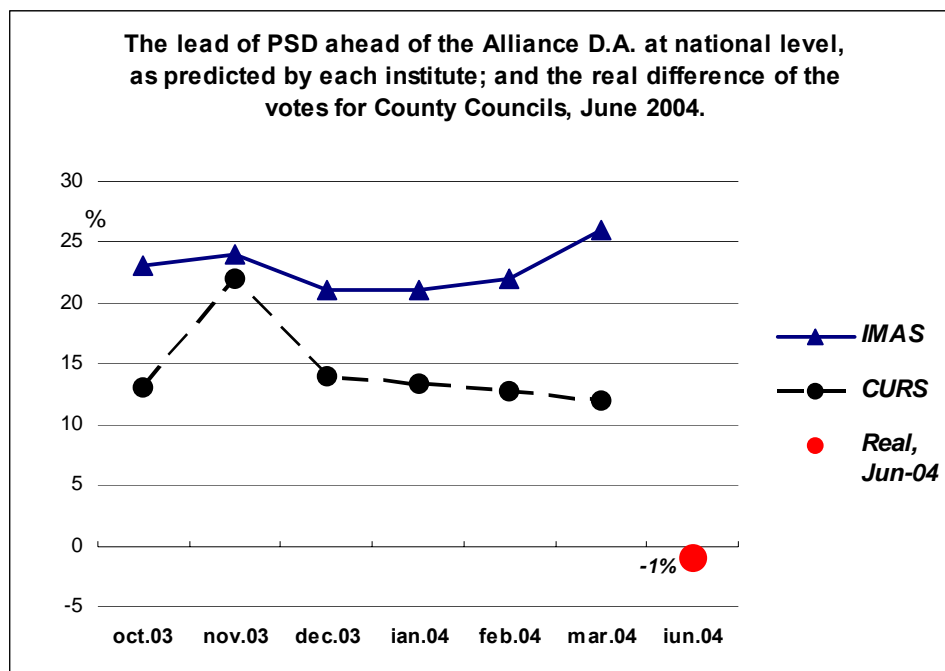
SAR's Forecast, March 2004

“45% of those declaring they would vote for the PSD today would also like to see a change at the 2004 elections, **and a quarter of the PSD constituency believes there is a viable political alternative to the government party.** The votes of this electorate will probably go to other parties during the electoral campaign – either towards the Alliance, or towards the PRM. A change is desired especially in cities with more than 200,000 people, in which the electorate would vote for the Alliance PNL-PD.”

Policy Warning Report No. 6/2004, Romanian Academic Society, March 2004

	Yes (%)	No (%)
Is there a political alternative capable of governing the country	42	39
Romania needs a change at the 2004 elections	72	19
<i>SAR-CURS Survey, March 2004</i>		

Fig. 3. The difference between reality and the predictions made by IMAS and CURS



There is actually no difference in methodology, which can explain this situation, as both percentages were calculated on the basis of those expressing an option – as was the case for the outcomes of elections for County Council. Moreover, the PSD percentage was growing according to IMAS, while the same percent was decreasing according to CURS. The same happened with predicting the outcome for the Alliance: IMAS forecasted a decreasing trend, and CURS an increasing trend. As a whole, CURS was much closer to predicting the outcome, and was wrong only with regard to the ratio between democrats and liberals. CURS has constantly presented the liberals as being twice as strong as the democrats. In general, democrats have been disadvantaged by all opinion polls, and especially by the mega survey conducted by CURS in December, which played an essential role in the process of distributing seats on the common lists of the Alliance.

It is also true that voters have overstated in polls their voting intention for the PSD. Presenting the PSD at 50% within surveys did not succeed in convincing the electorate, but managed to create an environment in which recruiting elites became much easier and in which ordinary people were more cautious when answering survey questions.

The electoral results are surprising only for those who trusted the surveys ordered by the parties themselves

What were the strengths of PSD?

The gains of the PSD in these elections have three major sources:

1. **Their control over local and regional elites**, especially in the least developed regions. This allowed for the manipulation of local resources, especially within rural areas (see the case-study below). The reason for which local elites support the PSD is their previous experience, which says that PSD policies would further allow them to control local resources. Government policies regarding landed

The PSD control over the public discourse has influenced local elites rather than voters; in villages power is exerted through traditional, pre-modern methods

property, forests' restitution and the form and bureaucracy of agriculture subsidies do nothing but foster the peasants' lack of autonomy within poor regions and the empowerment of those in control of local resources. This is a typical Third World pattern, which functions successfully in more than one third of Romania today, where the PSD leads by large in mayoral elections after the first round.

2. *Their control over electronic media*, through agenda-setting and through manipulation of independent opinion leaders. Analysts invited to different shows were either inhibited most of the time, because they were afraid of not being invited again, or showed a general kindness towards people in power. For instance, corruption was only discussed in general terms, while no clear corruption case of a candidate was brought up, although there were enough examples. The electoral show on TVR2, in which candidates from a certain city were invited together, but talked separately, instead of talking to each other, is a good example of a visible effort of preventing any consistent campaign. Moreover, the party-in-government was clearly favored through priming. The peak of this manipulation was reached on the 8th of June, when several TV channels, including the public one, have announced the cancellation of elections in Costinești, insinuating that the Opposition, i.e. the one initially afraid of electoral fraud, had been the actual fraudster. In reality, the Opposition was actually the one most affected by this cancellation, as it had won that constituency. However, the news supported the idea that it was not the government, but the Opposition, that was the fraudster in elections.
3. *Their control over authorities responsible for regulating elections*. Both the CAN (National Council for Audiovisual) and the BEC (Central Electoral Office) favored the PSD. The CNA made absurd interventions trying to limit general image losses of the PSD. Besides stupidly limiting the length of TV spots, they interfered in matters related to the contents of ads, which is a completely undemocratic procedure and has no precedent within consolidated democracies. Their interference affected the Opposition mostly. Such examples are hilarious, like, for instance, an ordinary TV clip of the PUR, which was banned by the CNA according to art. 60(4) and art. 64.c of the 67/2004 Act, i.e. because the clip did not prove "possible allegations with penal or moral incidence with regard to another candidate". How did the clip sound like?

"December 1989

Romanians risked their lives in the name of democracy

Can we actually talk about democracy in Romania today?

What kind of democracy do we have since corrupted politicians,

Paper billionaires and local lords humiliate us?

Since our children have to wait for hours in front of the doctor's office

And our parents survive on miserable pensions?

Since authorities fail as they did with the Mihailesti tragedy!

PUR fights for democracy!

Don't waste your vote on those

Who have disappointed you for the last 14 years!

Vote for PUR!

PUR ad banned by CNA

There was no reason for the CNA to ban such an ad. This is a clear case of censorship. The same happened with the Central Electoral Office (BEC). It rejected all the complaints filed by the Opposition, so that the PSD withdraws its own complaints. It first forbade the press to publish electoral

opinions one day before elections, and then canceled the directive. In general, communication with the media was very poor.

Fig. 4. Compared outcomes for mayoral elections

Political Parties	Mayoral elections % of mandates				
	1996	2000	2003, % of the mandates in-between elections	2004 first round (% of assigned mandates)	2004 first round (% of total number of mandates, 2727)
PSD	32	36	65	70	29
PD	16	16	10	6	2
PNL		9	7	8	3
CDR	12	5	2	--	--
PRM	2	2	1	0.47	0.22
UDMR	5	5	5	12	5

Case Study

HOW DO PEOPLE VOTE IN RURAL ROMANIA

The Third World begins 15 km away from Universitatii Square

The same as in the entire country, local elections were held in District No.17, Cornetu village, Ilfov county, on Sunday, the 6th of June. The same as in many other villages and towns, the favorite candidate was the current PSD mayor. The same as in the entire country, the three election offices opened at 7.00 a.m., after the urns, booths and stamps had been checked. However, we fear to qualify what followed since in Cornetu as a typical situation for elections in rural Romania. Although we have enough reasons to do that.

The village Cornetu has around 3000 voters on its permanent lists. Turnout was already high early in the morning. People were waiting in lines in front of two of the three voting offices: elder people and Roma. The latter came in large groups, led by a sort of "bulibasa" assistant (their actual "bulibasa"/leader is now the one from the Bragadiru village, as the one from Cornetu is in jail), who was 'monitoring' elections from 7 o'clock in the morning until late at night.

Although most of the Roma declared themselves illiterate, some had driving licenses or were able to sign their names just fine on the lists. According to Act No.67/2004, voters have the right to ask for a guide to enter with them in the voting booth, provided they have a well-grounded reason for that. In most of these cases, the guide was either the Mayor in-office, or a councilor. They would even offer themselves as guides when they were not asked for help directly. Their help came nevertheless more as a second control, because people had already been given certain 'incentives' right before elections. The mayor had obtained the authorization to connect the village to the regional network of gas pipes almost two years ago, but opened the pipes only a few weeks prior to elections. Moreover, a large number of the villagers had received their social aids only one week before elections, although the payment of these aids was due three months earlier. Voting was also allowed with expired identity cards, based on the confirmation of the police chief that the respective person really was who he pretended to be.

In two out of three voting offices, the mayor and the other candidates actively participated in counting the votes. As soon as the mayor's victory became certain (four times more votes than his closest challenger), he came out at the balcony and greeted the crowds gathered in front of the city hall (which was used as voting office), and then allowed people to come into the building in order to celebrate his victory. People were singing, cheering and insulting other candidates on the corridors of the City hall, while elections officers were still counting votes.

Strengths and weaknesses of the opposition

The best asset of the Alliance is its unity, not their own local barons who compete against those of the PSD; the party "strategists" who recommended separate lists should admit their error and step down

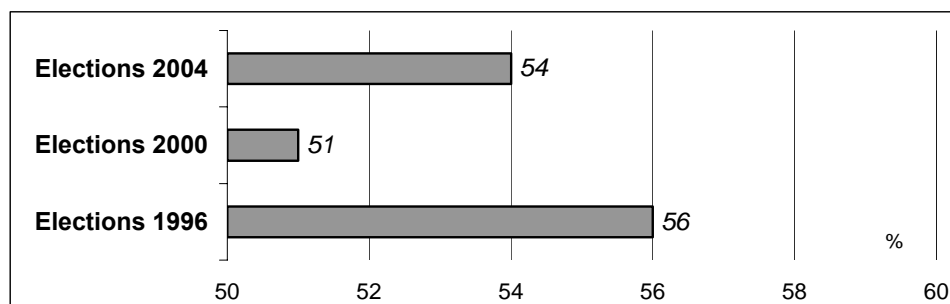
The Alliance pursued a good strategy in Bucharest, as it promoted the idea of a *team*, which had a tremendous success. On the other hand, it lost in those places, in which it did not use the same strategy. In Iasi, for instance, it lost to the PSD the majority predicted by the CURS mega survey, because of its division and its confusing message. It was a mistake not to sign electoral alliances for a single candidate both in Iasi and in Timisoara. Such alliances would have maximized their gains in terms of the number of mandates won. They will do this for the second round of elections for sure, but it will already be too late, as the majorities within the councils cannot be changed anymore. As a general rule, the Alliance benefited from an anti-PSD trend among the electorate. *This was the actual engine behind its major victories, rather than its own strategy.* Voters went for a change, and in places where they did not trust the Alliance (as in the case of Bacau, where the candidates of the Alliance had an 'impressive' record of corruption) they voted for any other alternative, such as PUR, PNTcd and so on.

What will happen in the general elections?

As the experience of former mandates show, the existent political framework in Romania would only allow it to be governed by a coalition. A legislative alliance with the PRM is hard to imagine. However, a party, which gains around 42-43% of the votes, plus some extra votes from redistribution, could have the majority in Parliament with an ally such as the UDMR or PUR. The Alliance stands the chance of getting this percent in general elections instead of the PSD, provided they pursue their Bucharest strategy in the whole country. SAR has previously argued that Traian Basescu would have made a stronger candidate in presidential elections. Traian Basescu and Corneliu Vadim Tudor have the highest potential for an electoral campaign. However, the final competition will take place between Stolojan and Nastase, partly because of the same questionable surveys. The competition seems nevertheless balanced, and the impossible looks suddenly possible: the PSD might lose both its positions, once the D.A. Alliance becomes a clear, credible alternative. The UDMR is a certain ally in any of the two possible outcomes. PUR needs to defend the position they gained on Sunday in legislative elections, so that they would be able to play the arbiter in this game. The PNL and the PD have a clear protocol, which entails enough details and allows them not to waste time anymore with what has been their major problem – balancing their respective influence within the Alliance. Nevertheless, they have little time to build a force capable of convincing Romanian voters, as well as the skeptics of the international community that they are a serious alternative, which is able to further successfully our European integration process.

Was the turnout low?

Turnout was low, but not lower than in 2000. The degree of mobilization among the electorate was higher. The real question is, again, why the surveys' predictions regarding participation were so far from reality. And, most of all, what should we do in order to better predict the turnout in the elections next fall. SAR's suggestion is to use an indirect question as a predictor for this. In 2004 the voter's level of competence (subjective competence) can be a good such measure. Voters who have declared themselves unaware of either political platforms or candidates did not go to vote.

Fig. 5. Turnout in local elections

RECOMMENDATIONS

1. Romania needs the permanent electoral body that the civil society has been requesting for years, a body more independent to political pressures than the BEC (Central Electoral Office). To this point, the BEC does not even have a consistent database of elections outcomes since 1992 – and there is no such database anywhere else. The only solution to the amateurishness and to the negligent manner in which elections are organized today is to create an authority that enjoys the necessary legal support and resources to avoid such situations.
2. The major beneficiary of political migration, the PSD, should realize that undemocratic procedures bear also costs, not only profits. Political migration needs to be eliminated in the future. However, this cannot be achieved through the bill proposed by the government, which is anyway at the edge of being unconstitutional. There is no need for amending the Constitution or passing an organic law for this. We can simply copy a model, which worked successfully for our neighbors. Slovakia managed to stop political migration by choosing the only possible way. The future members of parliament or future mayors signed their resignation with a blank date, agreeing to give up their offices once they decide to leave the party. At the same time, major political parties concluded a pact and agreed to accept these rules. Unless such a decision on behalf of the political parties is there, legislative amendments are useless: once the commitment of parties is there, there is no need for such amendments anyway. Therefore, SAR is calling upon all political parties to modify their internal regulations in this respect and respond to the request of the civil society to sign such a formal pact. The problem of political migration can be solved without changing any law, provided there is a political will to do that.
3. The CNA should organize a public debate together with specialized organization in the field of media and civic education with regard to its interference in the electoral campaign. We support the need of having a civilized campaign, but this does not include limiting democratic debate, as it happened during the 2000 general elections and the 2004 local elections.
4. The D.A. Alliance could have won elections, provided it ran as a single entity. Was it worth letting the PSD claim the victory in elections just in order to test the relative force of the two partners and satisfy a number of weak party branches? Such local party organizations are

actually afraid of unification because they fear competition and because their ultimate goal is not to win elections, but to further pursue their family business within their respective territory. SAR's recommendations are two folded in this respect:

- (i) Based on the analysis of elections performance, there is need to discipline all local leaders pursuing a selfish behavior, who risk to endanger a victory in general elections.
 - (ii) Furthermore, there is need to dismiss all those, who have 'scientifically' argued that separate lists would guarantee more votes for the Alliance. Provided the Alliance wants victory, it needs to create a single professional research department for presidential and general elections and give up such 'inspired' self-declared experts.
5. PSD should not look for imaginary scapegoats for its partial failure in these elections. Mr. Dan Ioan Popescu (leader of the Bucharest party branch) or Mircea Geoană are not necessarily to blame. PSD is now paying the price for its aggressive language and attitude imposed from the very top, a suicidal strategy pursued even these days by the same leaders who have a general negative image. Deceptive surveys and thinly disguised threats to the media and the civil society were issued weekly in press conferences by the top leadership of PSD. Therefore, the change in attitude should come from the same level, and not by penalizing local organizations. These organizations have actually paid for the general image of PSD as a corrupt and arrogant ruling party, which was emanated primarily from the center. PSD can win a lot if they manage to change this.

Local party organizations are not the first to blame for PSD's failure, but its aggressive and arrogant image projected from the top

SABOTAGED TACITLY FROM THE TOP, LOCAL GOVERNMENTS WILL REMAIN WEAK

We need to change not only people, but also institutions and processes in order to allow local authorities fulfill their mandate from citizens

Like many other former communist states Romania has embraced after 1989, out of conviction or just by imitation, the institutional philosophy of decentralization. The process was aimed primarily at:

- Defining the boundaries between local, national and shared functions and responsibilities of the state, and thus creating a true space of local autonomy in decision-making.
- And defining a list of local resources that are commensurate with the responsibilities of the local governments (LGs), which they can allocate and spend in accordance with local needs and priorities.

Important steps have been made on the second dimension, especially in the early nineties, with the passing of the first laws on LGs and local revenues; and in 1998-99, when new legislation dealing with local finance instituted for the first time in Romania the system of resource sharing based on automatic formulas, thus making the local budgetary process more autonomous, transparent and predictable.

However there has been less progress so far not only in addressing, but even in understanding the first issue. This is one of the important things we want to stress in this material, since it has been often overlooked by both practitioners and analysts: that additional local resources and more investments in "local capacity" will hardly make a difference for the citizen as long as the institutional framework remains fluid, with a substantial "informal" component; budgetary process remains volatile (the execution tolerates wide deviations from the planned structure); laws and regulations are interpreted with extreme "flexibility", including by the central government; many intergovernmental financial transfers remain opaque and unpredictable; and direct interventions to solve punctual crises predominate, at the expense of strategic thinking aimed at allowing local actors start dealing themselves with the problems they face. Sometimes, indeed, LGs do not have enough resources do take matters in their own hands. But, increasingly in the last years, resources cease to be the main problem in Romania – instead, our main problem becomes the lack of coordination and proper incentives at the local level, which lead to inefficient use of existing resources.

All these factors rule out the consolidating of institutions and stable expectations at the local level, and reduce the interest of local actors in devising own strategies and local development agendas. No matter how

FOCUS

Increasingly, the main problem is not the lack of resources but bad incentives and lack of real autonomy at the local level

LGs will build capacity only when they have motivation to do so, not just because there is some technical assistance available from donors

much assistance they are provided, LGs will develop own management capacities only when they have an incentive to do so, because they feel they gain from it politically or financially, and a stable environment to shape their motivation. As long as the gains are higher from other types of behavior, such as rent-seeking at the upper levels of governance, their participation in programs to "strengthen capacities" and create modern management instruments will remain formal, superficial. The problem is aggravated by the well-entrenched paternalistic attitude towards LGs in the Romanian nation state: they are not regarded as equals of the government by top officials and the public, no matter what the law says.

The Law on Local Public Administration is largely silent on the issue of the functions and responsibilities of local governments at all levels. Typically, it is the annual State budget law that defines implicitly these functions and responsibilities. Almost every year since 1991, the State budget law has added, modified or removed local responsibility for specific services, or for certain aspects of these services. Thus, acts which were supposed to be purely financial in nature affected substantially – and mostly by default – the structure of local government. Responsibilities for expenditures of both county and local councils changed frequently and on short notice. Even the direction of the change was oftentimes difficult to predict, as the responsibility shifted back and forth between the national and local governments and between county and local councils. However, the typical situation is when new "mandates" (mandatory policies decided largely at the center but which have to be implemented by LGs) are created overnight and passed down to LGs without much preparation. All these lead to a permanent state of semi-crisis at the local level. Two things happen in these circumstances which have serious consequences:

- The natural tendency of the central government is reinforced to intervene directly in order to solve temporary crises, through (half-baked) executive orders or prefectorial hyper-activism. For example, Emergency Ordinances imposing caps on the number of staff in LGs; or caps on certain types of expenditure even when these are made out of own revenues (communication, transportation, etc); or attempts to micromanage local funds by higher authorities who know better, when there is suspicion that LGs can make mistakes. Thus a vicious circle appears: without a clear space of local autonomy and responsibility LGs make suboptimal decisions, which lead to crises, which in turn lead to even more hasty measures by the center in the attempt to fix things by limiting local autonomy even further.
- Against this background of institutional instability and jumpiness, deliberate abuses and politically-biased decisions are more likely to happen.

Two additional factors have further contributed to the impression of instability and lack of direction of the decentralization process in Romania. First, in spite of the repeated complaints about the lack of managerial capacity at the local level, and in spite of the government's official strategies to strengthen and rationalize the structure of local authorities, small rural communes proliferate by the splitting of the existing ones. The latest such move happened earlier this year, when no less than 117 new rural local governments were created (and 27 former rural communes were upgraded to town status). There is a steady bottom-up pressure towards fragmentation in the rural areas to which the central government finds it hard to resist in practice, though it has been identified as a problem in its own official documents. This tendency will probably continue and

create serious economy-of-scale problems in providing services at the local level, thus complicating the process of decentralizing social services such as education and health care.

Second, "regionalization" as an issue periodically resurfaces on the public discussion agenda, sometimes embraced, sometimes rejected by the government, without ever being clear what its proponents mean by the term: the setting up of a new tier of local government proper (regions Polish-style), and in this case with / or without / the preservation of the current 2nd tier (counties); or something else, such as the mere strengthening of the current (rather ineffectual) EU-type Regional Development Councils. In either case there are precious few details about the functions to be performed by the new "regions", while the debate tends to focus primarily on symbolic, emotional issues such as their boundaries, would-be capitals and coats of arms. The danger in such half-baked proposals is that, by not being clear about goals, attributions and sources of revenues, they open the way for the other tiers of government to begin fighting political proxy wars over the design – but especially during the stage of implementation – of the new creation, and thus add a new layer of dysfunctional institutions on top of the existing ones.

Structural deficiencies of the current local government system

The general inconsistent definition of attributions in LGs creates cleavages / points of fracture where inefficiencies, paralysis and political games become possible at the local and county level. There are disputes about the lines of subordination: (i) within the LG (mayor-council); (ii) between tiers of LGs (counties-localities); (iii) between LGs and the deconcentrated offices (prefects, offices of ministries). The problems are general, but become most visible in cases of *political cohabitation* (mayor and local or county council majority from different parties), which occurs either as a result of elections or political migration (councilors switching sides). In some cases (Bucharest, Braşov) the tension has escalated in the past years up to a point where LGs operations become virtually paralyzed. This happened because in Romania the formal administrative institutions are weak, and so the main decisions are made informally in the backroom by informal party committees.

The status of the *Mayor* (elected directly) vis-à-vis the *Council* (elected on party list) and *Deputy mayor(s)* (elected indirectly, by the council) is not clear. The office of the mayor, as LG's executive branch, is not defined as a public institution in terms of responsibilities and legal authority, nor is its link with the "local community" as a repository of legitimacy clearly specified. The definition of the mayor as "the head of LG" is not operationalized in the list of functions, and becomes problematic in cases of cohabitation. In theory the mayor delegates some functions to deputy mayors, elected by the council from among its members, and continues to be responsible for what they do. This may lead to unworkable arrangements: the Council can pass functions to deputy mayors without his agreement, s/he cannot control or discipline them, but continues to be responsible for their actions.

Formally the mayors have no apparatus of their own, their offices belonging formally to the local council. Paradoxically, the mayor has little say in deciding the structure and staff of the apparatus he works with (unless he is able to exert control by informal pressures); but he is required to clear-out the staff chart of the deconcentrated services still incompletely decentralized, such as education (local schools) and health

The central government has a tendency to jump in and micro-manage, instead of creating rules and enforcing them uniformly

care (hospitals). The practice of the last years has shown that the Council has the authority to strip the mayor of functions, altering radically the structure of the LG. Examples are Bucharest, where there were attempts to alter the legal status of the mayor's office; or Braşov, the extreme case, where the council created a Service for Public Patrimony (SPP) under a standing committee of the Council, which took over the most important executive functions of the mayor's office, such as managing or privatizing local assets and contracting public services. Thus SPP got control over more than 50% of the local budget and begun to act as a parallel city hall (180 employees, vs. 230 in the city hall). It has authority over investment/development local functions, while the mayor's office was left responsible mostly with "unappealing" education staff payrolls and social protection services. All these could be summarized by saying that the Romanian mayor is

- defined theoretically as "the head of LG", and is politically accountable to the community in this capacity;
- but in practice does not have much more power than a city manager appointed by the Council. This dilemma is less visible when there is party alignment on both sides and thus a basis for informal negotiations exists; and becomes very visible in cases of political cohabitation.

The Local Council's *secretaries* (top local civil servants) are appointed by prefects and report only to them. Thus they represent an element of control / de facto subordination / of LGs to the central government represented by the prefect, in spite of the letter of the Constitution which postulates that no such subordination should exist. There are cases where the official contest for the position of secretary has been blocked for years. As a result the persons appointed by the prefect for this position function as interim secretary and does not even have civil servant status, thus lacking the minimal protection against political pressure associated with this status (in Braşov there were 7 such interim secretaries rotated by the prefect in this position in the last six years).

The secretaries are important at the local and county level, since they can undermine in practice the actions of the local authority they are supposed to serve (i) by action; and (ii) non-action, whether intended or due to incompetence, without being formally responsible for their action / non-action. For example the secretary can give legal clear-out to decisions which are subsequently sued in court by the prefect as illegal. In such situations mayors are threatened with suspension from office when 3 such cases are initiated, but nothing happens to the secretaries who are appointed by the prefect and responsible to them for failing to perform the legal screening, which is actually their main duty.

Prefects have a pro-county bias – they are a typical case of regulator captured by the regulated

Prefects have the main constitutional attribution to control the legality of the decisions made by local / county councils or mayors. But there is no proper mechanism to ensure the accountability of the prefect in this respect, and no single precedent where prefects were held accountable for their actions/non-actions. There is strong evidence that (i) there is political bias in the prefects' actions (Giurgiu, where almost all LC decisions are invariably sued by the prefect, allegedly in order to paralyze its activity), but especially *non-action* (ex. Braşov, in well-known cases of conflict of interest among local councilors); (ii) the prefects are far more active vis-à-vis local authorities (1st tier) than county councils, even when there are well-known irregularities at the county level (ex. the distribution of the equalization funds, which has always been done by in breach of

the Annual Budget Law provisions). Briefly, the prefects can choose not to initiate action against cases of their choice, without being held responsible for this selective enforcement of the law. Their relationship with the County Councils is a clear case of institutional capture of the regulator by the regulated.

Financial problems

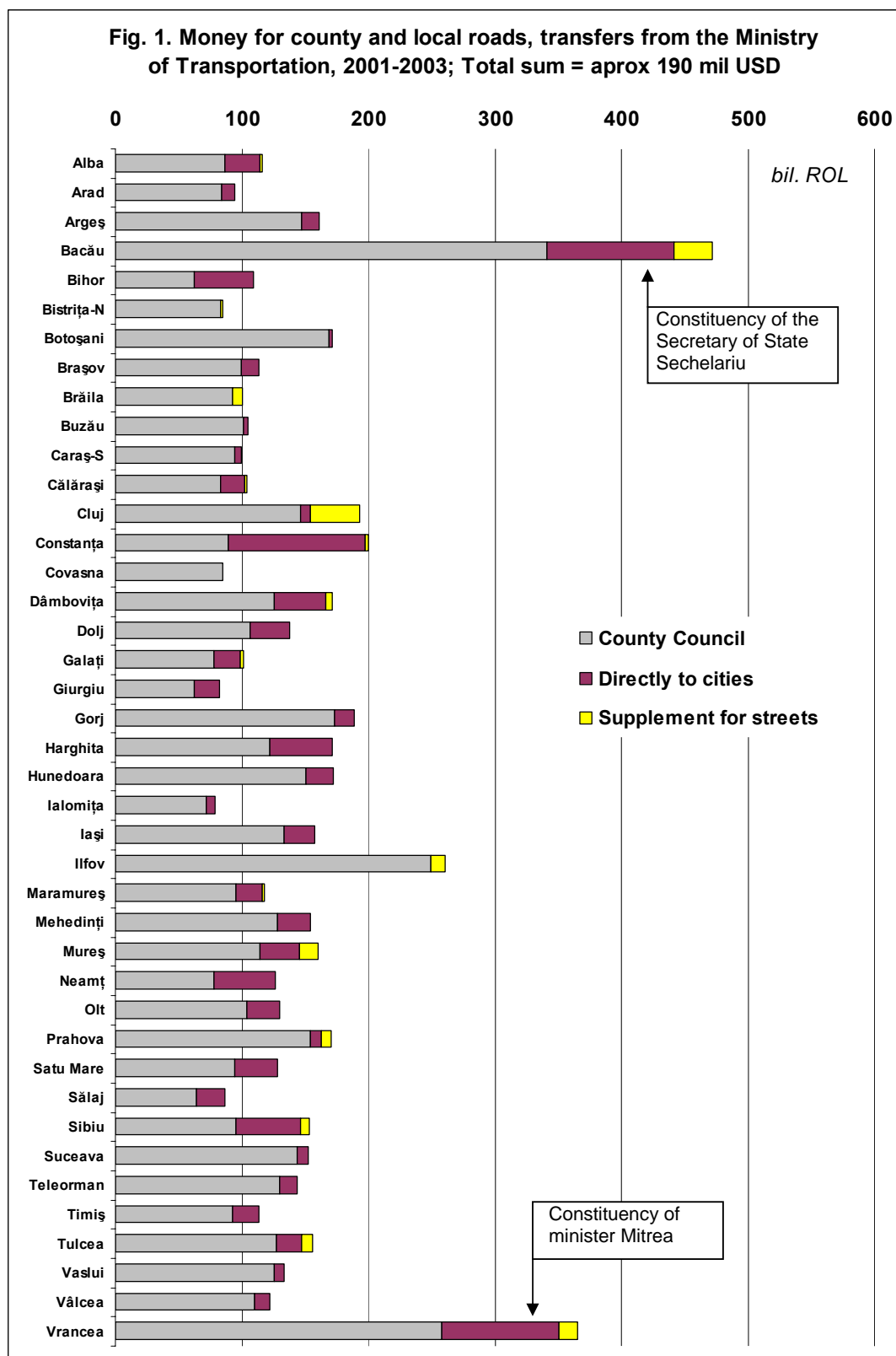
The financial relations between central and local governments do not currently support the clear delimitation of a space of local autonomy and responsibility, but paternalism from the center and ad-hoc solutions. It is true that many LGs do not have enough managerial capacity of their own. But on the other hand, one of the reasons why they are so slow in developing it is that the current institutional arrangement does not reward with proper incentives the emergence of local capacity, and instead encourages case-by-case "negotiations" and rent-seeking.

The *local budget process* continues to have the biggest adverse impact on the autonomy of county – but especially local – councils. With the approval of the State budget, often as late as February or March of a fiscal year that runs from January to December, each local government can adopt its own budget for the year. First, however, they must adjust their draft budget in accordance with the rules set forth in the current State budget law. In each year since 1991 this has included changes in the expenditure responsibilities of both local and county councils. It also has included variations in the volume and type of transfers, both general and earmarked. In addition, the local councils must wait for the county council to allocate to each one of them their corresponding share of the equalization grants received by the county council from the State budget. Briefly put, Local Councils face the absurd situation of having to wait for the Parliament to pass the State Budget in November-December, then for the Ministry of Finance to tell counties how much money they get from transfers, then for county councils to decide who gets what (and if the allocation rules which in principle are mandatory are applied or not), and only then they can meet and finalize the local budgets. It is practically impossible to be ready with it before January 1st when the fiscal year begins. If they move fast and there are no substantial discussions on the budget they may be ready in February-March.

There are two additional problems here which have made the local budgetary process more awkward, opaque and irrational than it should be. First, money are transferred from the center in two steps, first to counties which in turn distribute them by localities, even for those functions that are hundred percent local. Since all public institutions in Romania use the Treasury system there is no technical problem to send formula-based funds directly to localities, thus eliminating the unnecessary intermediation of County Councils/presidents. The second problem, which derives from the first, is that the allocation process typically displays different patterns in each of the 41 counties – which sometimes runs squarely against the provisions of the Annual National Budget Law. Even though, according to the text of ANBL, counties should strictly apply the fiscal capacity formula when distributing the general-purpose equalization grants, deviations from this standard are tolerated on a large scale. There has been no case of a prefect suing a County Council in court for breaking this money distribution rule. No local council knows for sure what amount they will receive from the county council. The process typically involves significant individual 'negotiation' between the local officials and the county council.

Rules are broken and money allocation criteria ignored, often by the central government itself; financial decentralization has so far benefited mainly County Councils at the expense of localities

The same conclusion applies to the allocation of the other transfer funds, particularly those for investments, and to the relation between counties and the central government. Fig. 1 below describes the allocation by



county of the money from the Special Roads Fund, which is supposed to be based purely on objective technical criteria¹, performed by the Ministry of Transportation and Public Works (MPWT). Obviously, it is not, and the deviations from the norm are so wide that suspicions of rent seeking and favoritism at the central level seem to be well grounded². When signal such as this are given from the top, it is hard to expect improvements at the local level in terms of more responsibility, self-reliance and accountability.

Rural communes, who are generally most in need, are the most likely to suffer from this erratic distributions of funds. On average, they are far more dependent on the transfers from the State budget than the towns and municipalities or the county council. In this context, it is not surprising that elected officials in many communes – the mayor and the members of the local council – have adopted largely a passive attitude regarding governance. Their most important skill is the ability to "negotiate" with the county council to secure the highest possible allocation. *Overall, we can summarize the history of fiscal decentralization in Romania by saying that County Councils were allowed to "confiscate" for themselves most of the space of local autonomy created by the central government in the last years, and now they exert this autonomy at the expense of localities whenever a conflict between tiers occurs.*

STEPS TO REFORM THE LOCAL GOVERNMENT SYSTEM: AN AGENDA FOR 2005 AND THE FOLLOWING YEARS

Urgent steps need to be taken to address the problems mentioned before. However, we believe this is unlikely to happen in 2004, even though public administration reform (PAR) is pressed by Brussels and presumably high on the government agenda, because:

- PAR is a sensitive and politicized subject and the current Romanian government, besides making promises and publishing fine strategies, has shown little appetite for real action; it is unlikely that things will change now, after the surprisingly poor performance of PSD in the June local elections;
- The deputy prime-minister in charge with PAR is currently running for the office of mayor in Cluj; in case he wins an interim minister will probably fill in for him, while if he loses he will come back just in time for the long summer holidays, before the campaign for national elections begins in September; in both situations there will be little time and attention for the process of decentralization, a task that cannot be delegated to junior ministers because it requires active support and coordination from the top cabinet level;
- While in other policy areas the technical know how is more or less available, the only problem being political will and coordinating implementation, in decentralization (a non-*acquis* subject) there is no ready-made template of reforms; various international partners often come with different plans, some better than others, based on clashing visions of the local public administration; once more, a strong

2004 is lost form reforms, but the new government taking office in 2005 should have a clear agenda for decentralization

¹ More precisely, on three such indicators: length of roads, their technical condition, and the volume of traffic.

² The two main winners, Bacău and Vrancea, are the counties of the Secretary of State and the Minister who decide on the distribution, respectively.

domestic capacity to coordinate actions is necessary.

This is why we believe we cannot expect major achievements in the area of PAR this year. On the contrary: hasty, politically-motivated attempts and half-baked changes are likely to do more harm than good. The agenda for action outlined below is therefore primarily meant to be considered by the new government resulted from the November 2004 elections, whatever its political composition.

Appointed prefects should not decide local policy over the heads of locally elected officials; the draft Law of Prefects currently in parliament is unconstitutional and should be scrapped

1. Amendments to the current legislation dealing with LGs are necessary, in order to clarify the relation between (i) mayors and local councils; (ii) local governments and the central government, with special attention paid to the office of the prefect. This is a broad, but urgent requirement, and it must be transposed in *concrete steps such as 2-6 below*, not empty promises or vague, inapplicable legal texts.
2. The elements of para-legal, informal subordination of lower LGs by higher level authorities should be reduced to a minimum, by combing thoroughly the existing legislation. *Council secretaries* should become full local civil servants, decoupled from the office of the prefect, hired and fired by the local authorities under the law that regulates their profession (conditions of studies, seniority, etc).
3. Crucially, any new piece of legislation must be consistent with the broader policy goals, not run against them. For example, there are provisions in the draft *Law of Prefects* adopted by the cabinet last month and sent to the parliament which introduce a de facto "opportunity control" by the appointed prefects over the decisions made by elected local councils (and not just "legality control" as it has been the case until now)³. Adopting such a law, and in the same time publishing a strategy purportedly aimed at "enlarging local autonomy", is nothing else but inconsistent policy. Moreover, we believe these provisions clash with art. 122 of the Constitution, which states that there should be no element of subordination between the elected tiers of government. The *Law of Prefects*, item on the famous "to-do list" submitted to Brussels, should be therefore withdrawn and amended by the government. In its current form it is likely to be blocked in the Parliament or end up before the Constitutional Court.
4. Other similar bad ideas should be dropped for good. In the last years there have been repeated attempts to enact a *National Code of Conduct* for local officials (mayors and councilors). The drafts discussed included provisions under which locally elected people could be suspended, or permanently revoked from office through administrative procedures only, outside the judicial system, by assorted "committees" made up of upper tier representatives, prefects and other central government officials, plus a number of fellow mayors from the same county (presumably members of FALR leadership). If passed, such a Code would open the way for politically motivated abuse.
5. Substantial changes in the local government structure – the passing of attributions from mayors to councils or the other way, or creating innovative structures like the *"metropolitan regions"* – should be

³ The prefect "participates in... establishing the local socio-economic development plan"... and "establishes, together with the local authorities, the priorities of territorial development". (art. 24-g). Also mentioned are "orders issued by the prefect in his capacity as County Council President (?!)" (art. 33).

carefully designed, discussed and agreed with all the stakeholders, and enacted so as to *take effect only beginning with the following electoral cycle*. It is perfectly Ok to experiment with different local arrangements – and also let the LGs themselves do it – but situations should be avoided when adjustments are temporary and politically motivated, leading to instability and dysfunctional structures.

6. Similarly, the government should make up their mind once for all what they mean by ***"regionalization"*** and what they intend to do about it. When a clear plan is drafted, preferably in the form of a White Paper, enough time should be allowed for all interested parties to discuss and give feed-back on it. As we made clear on several occasions, SAR is against the idea of creating regions as a new intermediary tier of government in Romania, because they would do little to address the current weaknesses of the LG system, as many people believe, while creating new problems of rent-seeking and coordination. But we accept that there may be merits in such proposals that we fail to see for the moment (it would be extremely helpful if the initiators, government officials or civic groups, could pull themselves together and put their proposals in written form). What is not acceptable is to cook such plans secretly in ministerial offices and pass them in haste through emergency ordinance, as it usually happens in Romania; or fuel speculation with oblique public statements by ministers when there is no serious reform concept behind them.
7. The ***local budgetary process*** should be made more independent and rational, in two ways. First, LGs should be free to decide, adopt and start implementing the part of the budget based on own revenues without waiting the go-ahead from the central government. Local budgets will thus have an "insulated" component completely decoupled from the national budgeting cycle, ready to become effective on January 1st. Second, it should be mandated by law that the transfers for LGs included in the national budget should follow a fast-track of approval both in Cabinet and the Parliament, so that they are adopted by, say, October 15th. This will give Local Councils enough time to discuss and adopt their full budgets before the new fiscal year begins. The current budget calendar is absurd, since it makes physically impossible for LGs to have a budget before the legal deadline of January 1st.
8. Financial transfers from the central government should be made as much as possible ***objective and automatic***, either in the form of tax shares or through formula-based allocations. A convincing step in this direction would be to move with the financing of pre-university education, after years of preparations and delays, towards a per-capita grant system. Similar changes can be made subsequently with the current transfers financing various social security mandates; or when substantial parts of the health care will be decentralized. However, rules like these must not only be adopted, but also ***enforced with determination*** in order to prevent situations like the one shown in Fig. 1 where narrow interest groups break the law and used public funds discretionarily.

The local budgetary process should be made independent from the national one; the current budget calendar is absurd

**County Councils
should not become
the refuge from which
local barons
defeated in direct
elections continue to
control the budgets
and policies of
localities**

9. Following the clear separation of functions between the two tiers of LG, *County Councils should be excluded* from the allocation of the general-purpose equalization grants and those transfers which finance purely local functions. Equalization sums should be divided from the beginning into two pools of funds – for counties, and for localities – and sent directly to the end user by the Ministry of Finance, based on the objective formula specified in law. Their intermediation is unnecessary and serves only to create patronage power at the county level. Otherwise, the danger is high that people who were rejected by voters in their localities in the June local ballot will move one level up at the County Council and continue to dictate local policies as presidents or deputy-presidents.
10. For those special funds or national programs administered by ministries where distribution based on automatic formulas is not possible, an *open system of competition with projects* should be institutionalized. LGs should apply for money publicly and the boards evaluating the quality of proposals should be broad, including experts from outside ministries (domestic, or technical advisors from the World Bank, EU countries or other bilateral assistance programs). Since we are talking about Romanian public money, all applications, successful and unsuccessful, must be archived and open to the public.
11. The transparency of the budget executions should be improved, and the most relevant data should be released *ex officio*, in order to make the whole LG system more accountable, for example on the web pages of the institutions. It is unacceptable that financial data like the one presented here in Fig. 1 are usually squeezed out from ministries with great difficulty, based on the Freedom of Information Act⁴. Daylight is the best disinfectant for public funds.
12. Finally, official commitments incorporated in strategies or legislative acts are credible only if they are backed by *political signals from the top* that the government takes their own rules seriously, follows up on them with concrete actions and punishes without discrimination those who deviate from the norm. Until now the acts of the central government have been inconsistent in this respect – for example by promising to depoliticize administration and reduce the number of small rural LGs when in practice they are doing the opposite, or by tolerating erratic distribution and use of public funds.

⁴ After we made them public some members of the Parliament thanked us because they had never been to get access to such data before.

ROMANIAN TELECOMMUNICATIONS AND THE EUROPEAN INTEGRATION

A few years ago, Romania, like other Central European countries, started negotiations and preparations for joining the European Union (EU). In the telecommunications industry this means adopting the *acquis communautaire* based on competition (the EU liberalized telecommunications on January 1st, 1998), and building an infrastructure compatible with that of the EU countries. Since then Romania closed negotiations on Chapter 19 and absorbed the EU directives, but these actions alone do not guarantee success.

Unlike Romania the EU countries fare much better in terms of telecom infrastructure. Moreover, they benefit from the substantial experience of the market liberalization in the last years. Transposing the EU legislation in Romania was the easy part; implementation is going to be more difficult; but overcoming the backwardness of the Romanian infrastructure is the really daunting task, since in this respect Romania is currently one of the least developed countries in Central Europe. Due to late reforms and a lack of understanding of the market mechanisms governing telecommunications, the industry, even with an evolution above the average of the economy, was not able to keep up with its counterparts in neighboring countries.

What should be done to close this digital divide in a period when the fixed telephony in Europe is in recession? First, we should stop treating the fixed telephony as a social service and introduce more substantial market incentives. Second, we should promote fair competition between various sectors of the industry – mobile and fixed operators. Last but not least, Romania should invest heavily in connecting the rural areas. Without proper infrastructure all the fine-looking strategies of the government – e-education, e-government, e-society – will remain empty buzzwords.

POOR TELECOM INFRASTRUCTURE

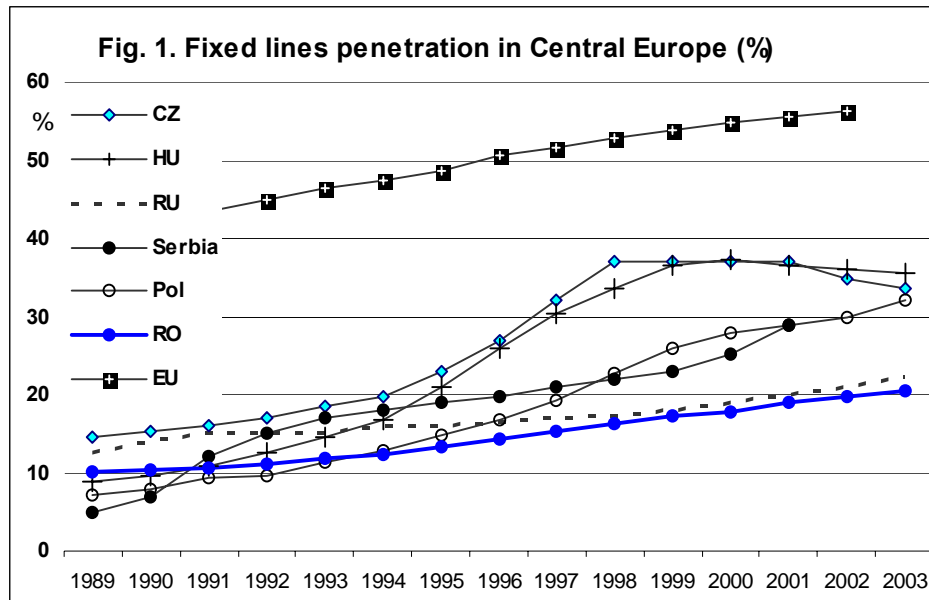
Romania delayed the reform in telecommunications for too long while the applied sectoral strategy positioned fixed telephony as a social service. The outcome was one of the weakest infrastructure in Europe, creating a gap too wide to be rapidly bridged.

Due to this delayed reform and lack of understanding of telecommunications economics, Romania has nowadays one of the lowest fixed line penetration in Central Europe despite the fact that in 1989 the country was well ranked ahead of Hungary and Poland. (Fig.1) Romania's penetration rate for fixed line telephony is about 20%, while in rural areas, where 47% of the population lives, fixed lines penetration is only 10%. There are many rural localities with no phone line (2 140 without fixed telephony, 993 without mobile coverage, 260 without fixed and

FOCUS

In 1989 Romania had a higher penetration rate than Hungary or Poland, but has fallen behind ever since due to delayed reforms

mobile telephony). Also, investment costs in rural networks are much higher than those in urban areas, with difficult investment recovery due to the poverty in rural areas. According to European Directive 2002/22/EC, member states shall grant telephony services to all end-users in their territory, independently of geographical location. For Romania, this means installing telephony networks in all villages with no phone connection.



Comparing the Romanian and EU telecommunication infrastructure one could find significant differences, which are due to general economic conditions and delayed reforms. Low tariffs left the national operator, RomTelecom, without sufficient revenues for a running a functional system⁵. A common feature of all East European countries, including Romania, was that political pressure to maintain low tariffs prevented national operators from rapidly expanding the network. If governments had not intervened with substantial subsidies, lower revenues would have contributed to poor quality of service and long waiting lists. Where privatization was delayed, the development of telecommunications infrastructures was slower. By privatization, the state offered a long monopoly period, a 'price cap' formula for increasing tariffs taking into account inflation and an increase in real terms was used in Europe: Hungary (Matav) and Czech Republic (Cesky Telecom). In Hungary, a very well prepared privatization process led both to a high selling price and a doubling of fixed lines penetration in four years: from 14.5% in 1993 (Matav privatization) to 30.4% in 1997. This is the result of large infrastructure investments, sustained also by increases in Average Revenue Per User (ARPU).

Why did Romania, in 1989 a country better placed than Hungary and Poland from the point of view of fixed lines density, become a laggard? The answer is delayed reform, in telecommunications but not only.

⁵ Roger Noll, *Telecommunications reform in Romania*, 2000

Hungary, a frontrunner in telecommunications restructuring in the region

Hungary is an example of timely reform in telecommunications. In January 1989 the regulatory body was set up, while the national operator, Matav, was established on January 1st, 1990, after separating postal and radio services. On December 31st, 1991, Matav became a joint stock company, owned by the Ministry for Privatization, in charge with management, restructuring and privatization. On November 23rd, 1992, the Hungarian Parliament passed the telecommunications law, enacted in April 1994. Hungary was divided into 54 operative zones, out of which 29 were reserved for Matav, 25 being the object of competition: 10 were awarded to Matav, while the remaining ones to companies from Israel, Switzerland, Portugal, France, and USA.

The privatization of Matav started in 1992. In September 1993, the offer for sale of 30% of Matav shares was launched. Matav privatization was sustained by world financial institutions through convertible loans made by auction announcement: IFC – US\$30m and EBRD – US\$60m. In December 1993, Magyarcom consortium (Deutsche Telekom, 50%, and Ameritech, 50%) was declared winner, despite the fact that their offer at US\$875m, was lower than the one of Stet and Bell Atlantic (US\$910m). Deutsche Telekom's experience in East Germany was appreciated positively. For investments made, IFC and EBRD received 1%, respectively 2% of Matav shares.

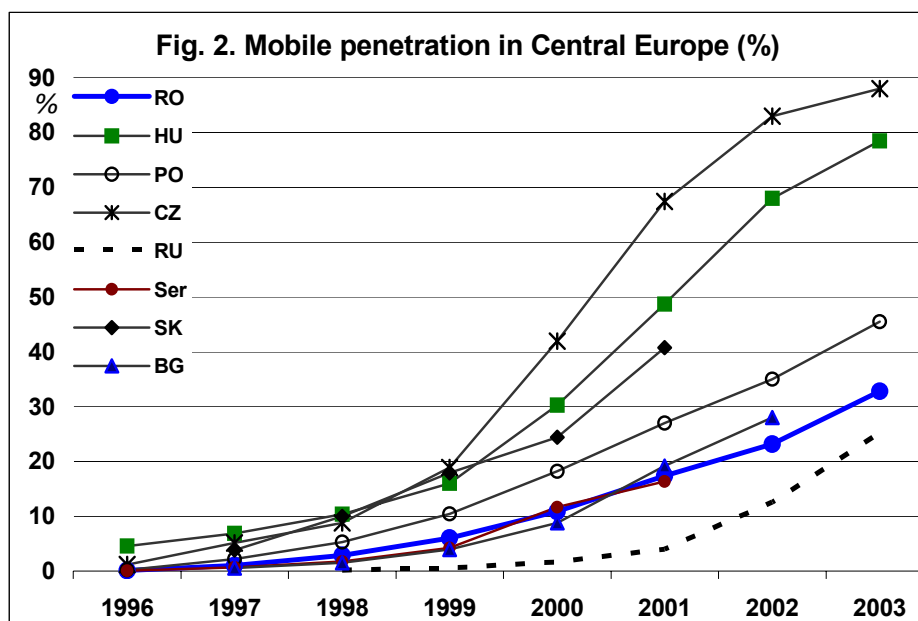
The winner received the company's control, concession for 25 years, eight years monopoly for long distance services, as well as, the task to maintain a yearly 15% growth of phone lines, and a 6 months waiting time in 1997. By the year-end 1993, Hungary had 1.2m lines and 14.5% penetration, while yearly ARPU was US\$393. Matav privatization valued company to US\$2.92bn, namely US\$2,412 per line, much over the value of a line in USA, US\$1,428, or in UK's British Telecom, US\$1,710. The success was the result of the early preparation of the company and a proper strategy.

In February 1993, seven months prior the auction and after a 15% increase of tariffs in real terms, the Hungarian government announced the 'price-cap' rule to automatically increase tariffs taking into account inflation, as well as costs. They chose the 'price-cap' formula as it stimulates investments and reduces uncertainty regarding the company's future cash flows. One should also take into account that at the time there were few shares for sale in national operators, thus the demand/supply ratio was quite unbalanced. In December 1995, Hungary sold 37% of Matav shares to Magyarcom for US\$852m, valuing the company at US\$2.3bn. Matav was listed and in November 1997 the initial public offering (IPO) was launched, by selling a 26.2% stake in Matav. As a result, the state obtained US\$1.017bn and the company was valued at US\$3.9bn. By the end of 2002, the state owned only the golden share, the majority shareholder being Deutsche Telekom with 59.2%.

The results? First of all, a boost of fixed line penetration from 14.5% in 1993 to 34.5% in 1998 and an average yearly growth of 9%, due to a US\$500m/year investment. Secondly, waiting list disappeared (0.785m in December 1993), and the old analogical exchanges were replaced by 1998. All these were possible due to the 'price-cap' formula, which created incentives for an investment intensive policy. The company's efficiency also improved: from 90 lines/employee in 1994 to 190 lines/employee in 1998, and 351 lines/employee in 2003. What is more, in

The recipe of Hungarian success: early privatisation, tough competition, foreign investments, and use of the "price-cap" formula

those times mobile telephony was in its infancy, so investments in telecommunications were directed mainly toward fixed telephony.



Romania, a case study in delayed reforms

By contrast, Romania is an example of how reform should not be done. In July 1990, the Ministry of Communications was established, and in September 1990 Rom Post Telecom was set up as the telecommunications, radio-communications and postal operator. According to government decision no. 448/June 27th, 1991, the *regie autonomă* RomTelecom, Poșta Română, Radiocomunicații and General Inspectorate for Communications (IGC) were established as distinct entities.

The national operator, RomTelecom, was established through government decision no. 448/1991, inheriting most of the assets of former Rom Post Telecom. Through government decision no. 673/October 25th, 1997, RomTelecom became National Telecommunications Company, a joint stock company with ROL1.958bn share capital (19,580,029 shares with ROL100,000 nominal value), owned by Romanian State and represented by the Ministry of Communications.

After a long privatization process started early in 1997, on December 30th, 1998 (five years after the Matav privatization), Greece's OTE paid US\$675m for a 35% stake in RomTelecom and 16% voting rights. This deal valued RomTelecom at US\$1.93bn or US\$540/line (privatization of national operators in Hungary in 1993 or Czech Republic in 1995 led to US\$2,400/line). The remaining stake, 65%, was owned by the Romanian state, of which 5% were to be sold to company employees by May 31st, 2000, IPO being also planned. In terms of managing RomTelecom, OTE concluded a contract with GTE allowing the US firm to negotiate a stake in company within two years. EBRD also had an option to buy a stake in RomTelecom, but none of these two options were exercised.

The second phase in privatizing RomTelecom started late in 2002, during the company's cash crisis and at a moment when the world

telecommunications crisis reached its peak, being concluded on March 3rd, 2003, when OTE transferred in Romania's accounts US\$30.99m, for a 3.12% stake in RomTelecom. The entire transaction, valued at US\$274m, consisted in a share capital increase entirely subscribed by OTE and an acquisition of a 3.12% stake for US\$30.99m. After this transaction, OTE became majority shareholder owning a 54.01% stake. A government decision on the privatization of RomTelecom, released on December 18th, 2002, approved the transformation of the golden share owned by Romanian State into a common share. On December 20th, 2002, the Romanian Senate approved the sale of RomTelecom stake, while on January 22nd, 2003 OTE's Board of Directors approved the transaction, as well. During this transaction it was accepted that the company valued US\$750m (namely US\$175/line) before share capital increase.

After take-over, a long and hesitating restructuring process began, with changes in organization (structure, culture and people), as well as in strategy (services, tariffs, partnership, etc.). A new organization is now emerging, with an emphasis on quality, efficiency and customer care. Personnel reduction was continuous during the past years, with 6,700 cuts in 2003 to 23,870 employees, while 2004 will bring 3,500 more job cuts.

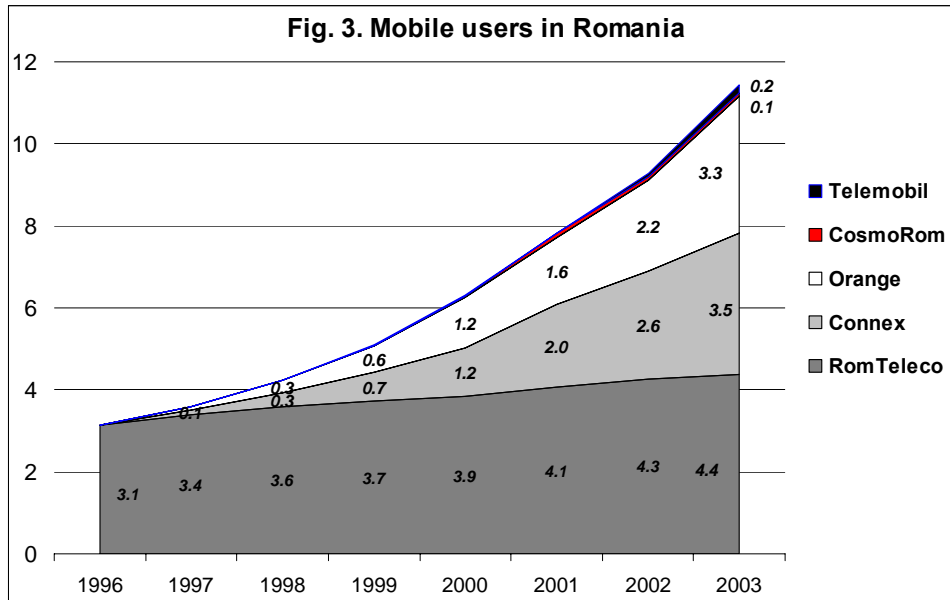
In 1998, a Government decision established the 'price-cap' formula for tariff adjustment, permitting changes in response to inflation or ROL depreciation, and an increase in real terms with up to 5%/year. Accordingly, in 1999 RomTelecom operated quarterly tariff increases but due to strong criticism in 2000 the practice was abandoned. As a result, RomTelecom reduced tariffs in real terms in last years: 11.4% in 2000; 10.2% in 2001; 6% in 2002 and 9.7% in 2003, relative to inflation. The 'price-cap' formula, which successfully contributed to doubling fixed line penetration in four years in Hungary, was forgotten. Moreover, until October 2003 RomTelecom was the only 'player' with tariffs denominated in ROL, all the others (mobile operators, cable TV operators, ISPs and even IGC) having tariffs denominated in US\$, and, consequently, revenues protected against inflation. To this, it has to be added that, after more than a year from liberalization, RomTelecom could not rebalance its tariffs, being forced by competition to reduce long distance (interurban and international) tariffs, without increasing local tariffs accordingly. In Romania, as well as in all countries before liberalization, higher long distance tariffs were used to subsidize lower local tariffs. Nowadays low local tariffs mean lower revenues for fixed telephony in Romania and, accordingly, poor investment capacity, and low attractiveness for local market.

Since 1990 Romanian fixed telephony had a slower evolution compared to other European countries – lower technical performance and penetration, poor quality of service -- due to low tariffs, insufficient for supporting development, the monopoly and political pressure. In this period, Romanian fixed telephony was positioned as a social service, resulting in one of the poorest telecom infrastructure in Central Europe.

Preparing for liberalization, a new telecommunication law was passed in 2002. Late in September 2002 the telecommunications regulatory body (ANRC) was established and struggled to create an effective implementation of the new European regulatory framework for electronic communications, a stable legal environment to encourage competition and to stimulate investments. The EU directives were adopted, the authorization process being simplified and some 2,200 entities asked for authorization according to the new law.

LIBERALIZATION, ONE YEAR AFTER

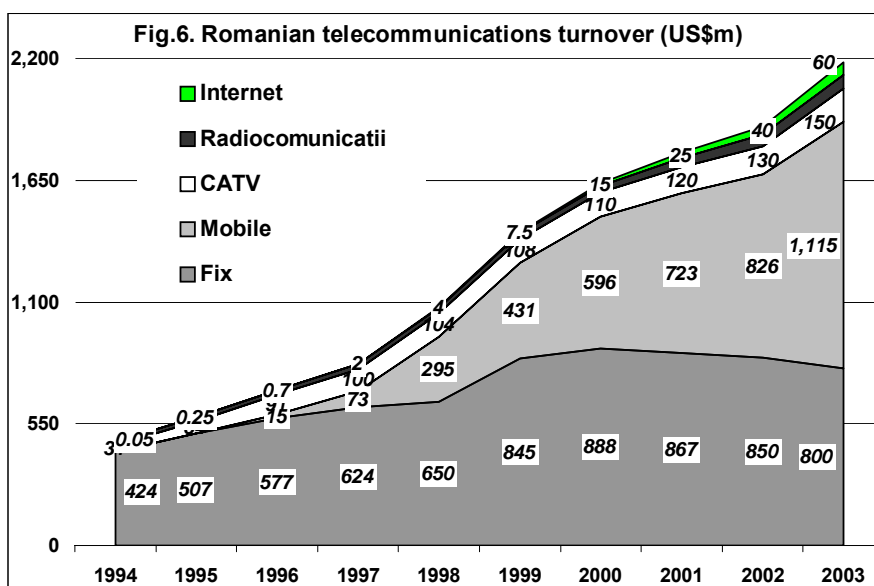
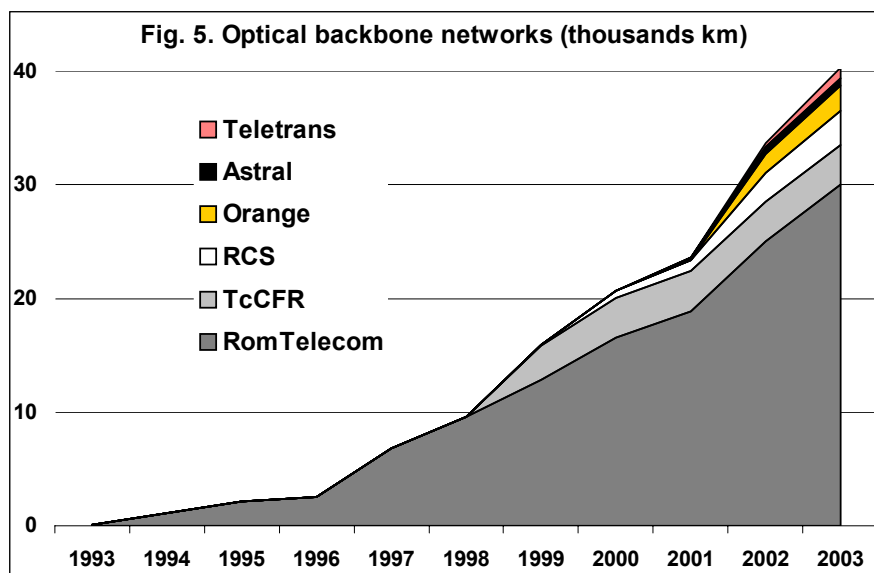
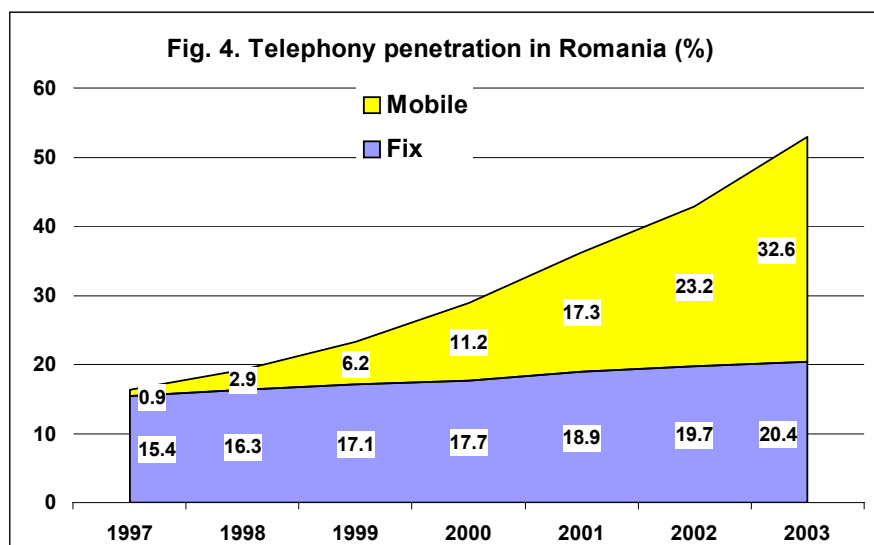
Strangely enough, the first year of liberalization meant the highest increase, of 2,000,000, in ... mobile telephony subscriber base, and the lowest increase, of 120,000, for ... the liberalized fixed telephony market. The year when mobile telephony subscribers rose by 2m to over 7m, brought another paradox – the failure CosmoRom, the first failure among GSM operators in Europe and maybe in world. Where the Romanian state was not involved in shareholders structure, companies did well. Other reasons behind these could be the lack of market regulating mechanisms, or, maybe, the existence of still imperfect mechanisms.



The liberalization of telecommunications seems to have had an inappropriate timing in Romania. First of all, it occurred too late, when the mobile telephony boom strongly decreased the interest for fixed line business. Also, liberalization appeared in the context of world telecommunication crisis, which strongly reduced telecom investments and made financing a difficult task. One should also consider the fixed telephony recession in USA and Europe – subscribers base and turnover decreasing continuously. Also, even in Central European countries, with a macroeconomic status weaker than the EU, classical fixed telephony entered a crisis.

**Spectacular
growth of mobile
phone users,
failure of
CosmoRom, the
lowest growth rate
of fixed phone
users**

The post-liberalization landscape seems to be not so interesting, as long as two markets, local and interurban – accounting for 80-90% of total turnover have few competitors. But the situation is not completely dull either, as the international market is very active: numerous competitors, most of them with small turnover, are fighting to arbitrate, as long as possible, between RomTelecom tariffs and VoIP tariffs in a price sensitive market. The result: a dramatic decrease of international tariffs and a slight increase of local tariffs – all too far from tariff rebalancing. The Romanian government is also intending to spur competition on the liberalized market, more precisely three ministries (MCIT, MLPTL, MCE), are each trying to launch their own operator: POSTelecom, Telecomunicatii CFR, Teletrans. Late in 2003, the first two competitors on local market commercially launched telephony services: Atlas Telecom (Oradea, November 17th) and Astral Telecom (Bucharest, Galati, Brăila and Cluj,



December 3rd). On April 6th, 2004, RCS/RDS also launched their fixed line services. By the end of 2003, telephony penetration in Romania was 53%, out of which 32.6% represents mobile telephony contribution. In 2003, in Romania the optical backbone networks length totaled about 40,000 Km, RomTelecom being the leader on market, followed by Telecomunicații CFR and RCS. (Fig.5.) Radiocomunicații also operates a 2,500 Km radio-relay backbone network. For time being the existing networks seem sufficient for current usage.

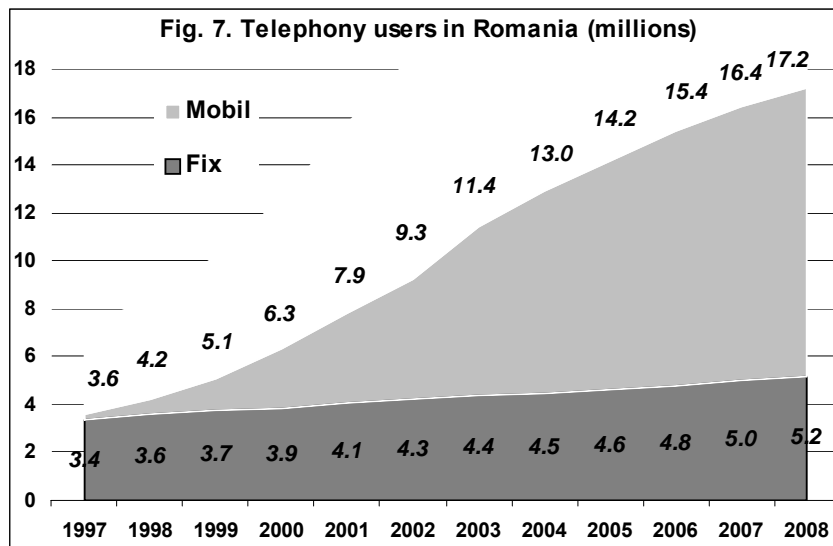
Romanian telecommunications turnover has continuously increased in past years, the growth engine being the mobile telephony, more precisely the GSM900 operators (Connex and Orange). Together, they account for US\$1.06bn, namely about 50% of total Romanian telecommunications turnover. If turnover from cable TV and Internet (totally owned by private capital) is added, one could see a decreasing weight of state capital in Romanian telecommunications turnover.

ROMANIAN TELECOMMUNICATIONS IN 2004

Mobile telephony will continue to be the engine of Romanian telecommunications. The GSM900 operators, where Romanian state is not a shareholder, will continue to consolidate their market positions, increasingly providing their clients with bundled services (voice, data, Internet - fixed and mobile) to RomTelecom's detriment, being in a better position for convergence.

The GSM900 operators will continue to be the driving force of the telecom sector; they are now better prepared for convergence than RomTelecom

In 2004 mobile telephony will continue to have a two-digit growth - 15% - 25%, thus by the end of the year the number of subscribers will be over 8m, while tariffs are expected to continuously decrease. However, without a special interest in 3G, it is possible that in 2004 four 3G licenses will be awarded. It is most probably that this will happen after the revitalization of CosmoRom in order to have four mobile operators for the four licenses. In all likelihood GSM900 operators will buy 3G licenses using UMTS technology, a technology without special results in region. Before December 2003, Hungary postponed the award of 3G licenses for 2005. The reasons consisted in lack of interest, unprepared market, and technological problems. Romania could also learn from this experience. The electoral year could be a chance for the rescue of CosmoRom, but a decision should be taken rapidly.



Fixed telephony will continue its modest evolution with slight (<5%) increases in the number of subscribers, while the industry turnover could continue to decrease. (Fig.6) Competition on the international market will continue to be strong, while the arbitrage (between RomTelecom unbalanced tariffs and VoIP tariffs), very attractive in 2003, will become less and less attractive, due to increased competition. This could create problems, mainly for small companies (ISPs), paving the way for failures, mergers, and acquisitions. At this time, competition on domestic long distance market would be welcome. It would be time for Radiocomunicații, Telecomunicații CFR, Teletrans to enter the market, and this could trigger tariffs reduction. Once again RomTelecom could be in a delicate situation being forced to reduce its interurban tariffs without increasing accordingly local tariffs.

Probably, Telecomunicații CFR and Teletrans will continue to develop their optical backbone networks, even if the existing backbone network seems to be enough for current needs. Already, one heard voices speaking on the surplus in transport capacity in Romania and even on future failures. Bankruptcies in telecommunications throughout the world affected mainly carriers, their effects being supported by private capital, not public funds. This scenario might not be repeated in Romania, taking into account shareholders' structure, namely the presence of the state. Anyhow, the life on the long-distance market will not be easy, surprises can be expected, and a solution to avoid them is privatization by attracting a strategic partner and investment funds. Evolution towards a full service provider (local and long distance, data, voice, etc.) using low investments technologies could be another solution for risk reduction, but it assumes partnerships with other competitors and thus requires time.

Telecomunicații CFR and Teletrans operate backbone networks providing a package of services to a closed group of users. Restructuring these companies, transformation of network administration into a business, is a complex process, which should be rapidly done. There is an umbilical cord limiting evolution of these companies, while cutting it, by privatization via attracting a strategic partner, could accelerate the companies' evolution. A strategic partner will not only bring the industry expertise, but also access to international finances. Presence of investment funds in shareholders structure is guarantee for increasing the company's market value on medium term, while also acting as antibodies, both very important for a new entrant on liberalized market. Prior to privatization, Radiocomunicații should be reorganized separating state interests (TV and radio broadcasting) from the ones addressing the market.

Atlas Telecom, Astral Telecom and RCS/RDS have commercially launched their services, thus users have now the chance of an alternative to RomTelecom's services and of comparing service quality. Romanians have the opportunity to see how these technologies work, while Romania could continue to be a trial field for new technologies (wireless/WLL mainly). So, new players could enter the market using cheap access technologies (WLL), providing telephony with limited mobility. In 2004 one could expect the boom of limited mobility telephony, a service placed between fixed and mobile telephony, and which had a huge success in India. There, it was launched as mobile telephony for poor population and thus it could be a solution for Romanians, which also are not too rich.

POSTelecom might enter the market this year too, the last announced deadline for commercial launch being autumn 2004. POSTelecom could benefit from the presence of China Unicom in its shareholders structure,

Telecomunicații CFR, Teletrans and Radiocomunicații must be urgently restructured; they need a strategic partner and and/or of investment funds

having the advantage of a business built from scratch: using latest technologies (IP centric network, lower investment/line comparing to classical telephony, lower operational costs, etc.), hiring necessary personnel (number, skills, etc.), and building a market-oriented organization. POSTelecom has the disadvantage to have the Romanian state as a (majority) shareholder. It is also interesting to see the impact of a Chinese product, 29% at the beginning, on a price sensitive market using western products. Very important will be the cooperation among shareholders. Success is also depending on the speed of network deployment and business development, as well as on the package of provided services, quality, and tariffs. But, for time being...

In the conditions in which RomTelecom will not have permission to rebalance its tariffs its revenues will continue to decrease. RomTelecom operates a 'capital-intensive' and 'labor-intensive' network, a voice-centric network, with expensive operation and providing only a limited package of services. This is a reason for RomTelecom to lose ground in favor of its competitors using modern technologies. Another problem is a modest evolution of its mobile arm, CosmoRom, more precisely a too much delayed restructuring. RomTelecom is a unique case in Europe, being the only national operator without a strong mobile telephony arm - mobile telephony representing less than 2% in total group turnover, compared to 40% in Hungary's Matav, or OTE. CosmoRom needs a strategic partner, a mobile telephony operator with at least a regional strategy, able to build a new business model; an operator able to compete with Orange, Vodafone, TIW and to provide easy access to international financing. The partner should bring affiliation to a strong telecommunications group. The decrease in RomTelecom revenues could be compensated by costs cuts, as a result of company's restructuring, so an increase in company's efficiency is expected.

**Due to the
Cosmorom failure
RomTelecom
became unique in
Europe: the only
national company
without a strong
mobile telephony
branch**

Competing technologies in the local loop

Two technologies were competing in Romania before market liberalization: classical fixed telephony and mobile telephony, especially GSM900. Penetration of these two technologies was similar by the time of liberalization, but currently mobile telephony has a higher increase rate (two digits). After liberalization, a third technology – cable TV, existing in Romania since 1990, became a potential competitor, and after the commercial launch of Astral Telecom and RCS telephony services this technology became a real competitor. In November 2003, Atlas Telecom launched telephony services using DECT technology, a wireless access technology (WLL), while other WLL technologies might also be expected.

Which one of these technologies will succeed in a price sensitive market? Certainly, the 'cheapest' technologies. With US\$600/line, the RomTelecom technology is by far the most disadvantaged. If taking into consideration the existing tariffs, the disadvantage is much higher. Potential market is much larger (80-90% of population) for wireless technologies addressing individuals, compared to wire technologies (35-40%) addressing families. (Tab. 1) That is why the growth is much higher for wireless technologies, and the future seems to belong to them.

Tab. 1

Techology/Company	CDMA450 (Zapp)	GSM 900	Fixed Tel (RT)	CATV	DECT (Atlas)
Potential market	population	population	families	famillies	population
Marginal investment (\$/line)		200–300	> 600	200–400	~100 (?)
Local tariffs in PH (\$/min)	~0.02	~0.10	~0.03		0.03
Interurban tariffs (US\$/min)	~0.02	~0.10	~0.10		0.03
Revenue in 2003 (US\$/line)	~ 300	~200	~200	50 (Tv)	
Growth in 2003 (mil./%)	0.14	2m/40%	0.12/3%		
Turnover in 2003 (\$ m)	48	1060	825	150	
Lines/employee in 2003	n.a.	~1500	~180	300–400	
Growth in users in 2004 (%)	50%	10–20 %	~ 5%	< 10%	
2004 turnover (\$m)	75	1250–1350	800–850	150–170	

COMPATIBILIZATION OF TELECOM LEGISLATION WITH BOTH THE EU ACQUIS AND THE NATIONAL CONDITIONS

Two acts with a special impact on industry were passed in 2002, and could be enacted this year. These laws are applied in the EU, a region with much more developed economies and telecommunications compared to Romania. Implementing them in Romania should take into account these differences. Most of EU countries have liberalized their telecommunications on January 1st, 1998 and their experience should not be neglected.

Universal Service Obligation (USO)

One of these acts is the law of **universal service (directive 2002/22/EC)**, which could be enforced this year, and for which 1% of the operators' turnover was proposed to ensure resources. According to directive 2002/22/EC, member states shall ensure that telephony services are available to all end-users in their territory, independently of geographical location and at affordable price. Prior to analyzing the effects of enforcing USO in Romania, let's focus on its features. Countries have put USO in practice after reaching a certain level of development, in order to benefit specific low-income social groups, or groups living in remote areas (insular, mountain, or rural). Universal service was provided in education, health, water, railroads, etc. in order to create a level playing field for a minority of disadvantaged citizens. Could USO be applied in Romania? What constitutes a minority in prosperous countries is a majority in Romania, poverty being a widespread phenomenon.

For USO every company should pay 1% of its turnover to create a fund to finance it. In 2003, the industry turnover was some US\$2.2bn, so in 2004 US\$22m might be raised, enough for 10,000 – 20,000 new lines in rural areas. 47% of Romanians live in rural areas, fixed lines penetration being under 10% (as compared to Romania's total penetration of 20%). Installing 20,000 new lines yearly, penetration could only increase by 1% in ten years. The proposed mechanism will not work properly, the funds raised being too low for Romania's needs. Also, these funds for USO should not

The funds raised from the 1% turnover contribution are too low to meet the Romania's needs; additional sources must be found within and outside the industry

come from telecommunications, which despite of its evolution much over the national GDP is still ranked on last positions in Europe.

It is true that EU countries use the "1% mechanism" but not for addressing half of country's population. This 1% should remain in telecommunications, as long as most operators encounter problems. RomTelecom was trying to raise US\$200m, CosmoRom has problems regarding its survival, and Telemobil tries to raise US\$100m for development. MobiFon (Connex) and Orange have more than US\$200m in debts. There are also other examples to show that Romanian telecoms are in a fragile equilibrium, which could be disturbed with serious consequences by an imposed implementation of USO. More, it's time to help telecom operators to pass this period, as other EU countries are doing.

An example of brutal application of USO comes from Czech Republic where, according to Financial Times (February 23rd, 2004 issue), Cesky Telecom sued the national regulatory body to recuperate losses due to USO application. Cesky Telecom accused the regulatory body of refusing a proper increase in monthly subscription necessary to cover losses. According to the privatization contract, Cesky Telecom was forced to invest US\$5bn in network modernization, while the mobile telephony boom and the 2001 liberalization forced the company to reduce long distance tariffs. The regulatory body has permitted only a small increase in local tariffs even if these were only half of West European tariffs. Investments made have become inefficient, affecting seriously the shareholders interests. It is important to remember that RomTelecom also took into court ANRC for similar reasons.

Certainly, Romania should develop its telecom infrastructure and much more funds should be attracted. It is crystal clear that using telecom industry resources was not sufficient to keep pace with Europe, while imposing a 1% fee on industry turnover will only use the industry's scarce resources the gap being too wide to be closed. New funds must be attracted, first of all those generated by Romanian telecommunications. For instance, the sale of four 3G licenses, which could raise US\$140m; the sale of important stakes in RomTelecom, Radiocomunicații, Telecomunicații CFR, Teletrans raising around US\$500m; fees paid by telecom operators (frequency usage, etc.). It is very important that all these telecom funds contribute to telecommunications development. Or, Teletrans, Telecomunicații CFR, etc. privatization should be done by share capital increase so its results will contribute to telecom infrastructure development.

Other financing resources could come from the state budget and EU funds. Romania should include in its budget funds for rural areas telephony. In late 2003, Minister Mircea Geoană announced €3bn funds for Romania via ISPA, SAPARD and PHARE programs and other infrastructure projects for 2004 - 2006. In February 2004, the EU has announced €10bn during the 2007 - 2009 period to accelerate Romania's rural development. An important part of this money should be directed towards telecommunications, to become an engine for Romania's sustainable economic growth.

The law of universal service, as formulated today, is an excessive regulation (too many obligations for providers, etc.), which is against the liberalization spirit that is deregulation.

Local Loop Unbundling (LLU)

Another law, probably coming into force this year, is '**Local Loop Unbundling**' (European directive 2002/19/EC), according to which new entrants will have access to RomTelecom 'local loop' - circuits connecting exchanges with customers. LLU was launched 20 years ago in USA and UK, countries that were de-monopolizing telecommunications. At the time mobile telephony and cable TV did not exist, and without other alternative, the access to incumbents' local loop was meant to spur competition. The only local loop considered was the symmetrical pair, not the coaxial cable used by cable operators, or radio channel used by mobile operators.

After 20 years, USA, a pioneer of de-monopolization, is reconsidering its position and becoming a pioneer of 're-monopolization'. Thus, FCC, the US telecoms regulatory body, adopted regulations meant to limit access to incumbents' local loop. They considered more important protecting the main operators during the telecom crisis rather than obtaining some hypothetical benefits. UK is also intending to reconsider its position. Late in 2003, Stephan Carter, executive director of the newly established regulatory super-authority – Ofcom - was considering whether they should continue encouraging new entrants to use British Telecom infrastructure, or rather support competition in infrastructure. This happened in UK, a country that can not complain about lack of infrastructure. In general, LLU use has not led to competition, strong competition occurring where LLU did not act. The strongest competitors for incumbents are cable and mobile operators in USA, while in Europe mobile operators, mobile telephony penetration being double compared to fixed telephony.

Liberalization of telecommunications in the EU took place on January 1st, 1998, when the fixed lines penetration rate was on average 52%, the infrastructure being well enough developed for new entrants to rent (e.g. local loop); all this while mobile telephony and cable TV were in their infancy. The results of LLU were not at all outstanding: five years after liberalization Deutsche Telekom had 98% of German local market, while UK's British Telecom has 82% of local market after 20 years of liberalization. One year, one percent!

In Romania, liberalization unveiled a poor fixed infrastructure, ranking it on the last places in Europe: some 4.4m lines, 20% penetration, waiting list, manual exchanges, etc. New entrants have scarce local loop resources to access. Access could be easier to mobile networks, which are better developed (over 7m users by end of 2003, covering 95% of population), or to cable networks, which wired some 45% of Romania's households. But, the law does not specify how LLU can be applied in the case of mobile and cable networks.

The experience of other countries did not reveal spectacular results, except clashes with incumbents. Which could be the results of LLU in Romania? Besides repeating other countries experience, LLU could detour investments from developing local infrastructure, while Romania's priority would be to reduce the gap in fixed line penetration compared to European countries. LLU has generated competition in retailing, which proved inefficient even in countries with developed infrastructures. Romania is trying to implement a European legislation that has not revealed outstanding results, and that was not yet abolished by world telecommunications.

20 years ago, LLU was meant to spur competition; today in Romania it may detour investments from increasing penetration rate

Fair regulations for a fair competition in Romanian telecommunications

Since 1997, when GSM900 operators were launched, fixed and mobile telephony has competed on the same market, that of telephony, a fair competition being necessary.

Mobile telephony: tariffs are too high

Romania is the only country in Central Europe with two mobile operators (Connex and Orange) having 96% of the mobile market. Usually in Central Europe the third operator has over 15% market share. In Romania we have a duopoly structure, which may stifle competition. This was possible due to the outstanding performances of GSM900 operators and a favorable context. The latter includes the repeated attempts of Telemobil to re-launch its services, the delicate situation of CosmoRom, as well as, the regulatory frame. Today, despite of lowest costs (Capex, Opex), termination tariffs in a mobile network are the highest. For instance, at the commercial launch, a call from Atlas Telecom network to a mobile operator was more expensive (€ 0.14/minute) than one toward a European country (€0.12/minute). Very high termination tariffs are discouraging competition on telephony market, preventing small companies from growing. Currently, investments in mobile telephony are much lower (~US\$300/user) compared to classical fixed telephony (~US\$600/user), while strangely, tariffs even in the same network are higher. (Tab. 1) Other curiosity: the only monitored (namely, limited) tariffs are fixed telephony tariffs. High mobile telephony tariffs are inhibiting competition, making small companies to become smaller, on medium term.

Putting mobile tariffs on costs can encourage competition. Termination tariffs in mobile networks should be equal to those in the fixed network: 0.0255€/min, instead of the current US\$0.10

It should be mentioned that investment levels of the three mobile technologies operating in Romania are slightly different. For this reason, tariffs for mobile calls terminated in the same or in other networks should be approximately equal. If tariffs were put on costs, those for mobile telephony could be lower than those for fixed calls!

Putting mobile tariffs on costs (based on the LRIC model, for instance) will eliminate a competition barrier, paving the way for a fair competition in Romanian telecommunications. Until this will become a reality, one should establish termination tariffs in mobile networks at the level of termination tariffs in RomTelecom's fixed telephony network, namely €0.0255/minute during peak time, instead of the existing US\$0.10/minute. €cents2.55/minute termination tariff could be a beginning.

Fixed telephony: between a social service and the much delayed tariff rebalancing

If the mobile telephony is a deregulated market, fixed telephony, the recently liberalized market, is still an over-regulated one. Liberalization, by opening three markets (local, interurban and international), should lead to rebalancing of tariffs. This is needed, as the new competitors will offer services based on own costs, not being obliged to offer subsidies. Strong competition on the international market has triggered dramatic decrease in tariffs, market players being happy to arbitrate between RomTelecom's high tariffs (to subsidize local calls) and the low VoIP tariffs. Something similar will happen on interurban market as new competitors enter, placing RomTelecom yet again in a delicate situation.

Doubling telephony penetration in Hungary between 1994 and 1997 was possible, *inter alia*, due to the 'price-cap' formula, permitting investments

of US\$500m yearly. Today, RomTelecom may decrease long distance tariffs but is not allowed to increase local tariffs accordingly. The result being that the local market is blocked. The official reason for controlling local tariffs was the lack of competition, while poor competition is the result of an unattractive market: high investment and low return due to controlled tariffs. To break this vicious circle one should permit market mechanisms to act. Consequently, local tariffs should be established by demand and supply, as it happens in any competitive market. This is a way to de-block the local market and to eliminate the existing telecom gap.

Competing with mobile telephony and new technologies, classical fixed telephony has no real chances in the existing context (higher investment/line, lower tariffs compared to mobile telephony, etc.), so on medium term one should determine if Romania still needs fixed telephony. If the answer were positive, assuming that Romania does not afford to stop using the fixed phone network, then the market mechanisms should be allowed to act in telecommunications. It is the time to let the demand/supply mechanism work in the Romanian fixed telephony local market, too. Let's leave the market to establish the local tariffs. In all likelihood a rational operator will not impose too high tariffs to lose its clients and to bankrupt its business. It is therefore the time to consider fixed telephony a business, as mobile telephony was until now.

Liberalization, also called deregulation, will succeed only if it really means a market deregulation. The current over-regulation (tariffs control, USO, etc.) in fixed telephony will hinder the operators' evolution and will act as entry barriers for newcomers. Other countries experience has proved it, and it is a big mistake to ignore it.

Fixed telephony should be regarded a business, like the mobile telephony; the market must be allowed to set local tariffs

CONCLUSIONS

- Due to delayed reform and lack of understanding of the telecommunications economics, Romania has today one of the **lowest fixed line penetration rates (20%) in Central Europe**, even if in 1998 it was ranked ahead of Hungary and Poland. In the rural areas, where 47% of the population lives, the density is even lower – 10%.
- Romania's main problem remains the local network. For bridging this digital divide **large investments are needed to be attracted from outside the industry**.
- **The fixed telephony must be regarded as business and not a social service.** Political pressures to reduce tariffs lead to a low quality of the service, waiting lists and a slower development of the fixed local infrastructure – gradually placing Romania on the lowest rank, in what penetration rate is concerned, among Central European countries. Liberalization, on January 1, 2003, lead only to deregulation of the long distance tariffs. The local tariffs must also be freely established by the market. This can act as means to unblock the local market and reduce the gap between Romanian and the rest of Europe, while RomTelecom could rebalance its tariffs. The Law for universal Service represents and excessive regulation for Romania, being in contradiction with the practice of market liberalization.
- **Legal framework for a fair competition. (1)** In the competition with the mobile telephony, the fixed telephony is technologically disadvantaged and also overregulated. **Liberalizing the fixed phone**

services could lead to a fair competition. (2) Placing the mobile tariffs on costs (following the LRIC model, for example) will eliminate a barrier in the way of competition.

- **Encouraging competition in mobile telephony. (1)** Today the GSM900 operators have some 96% market share, which is a unique situation in Europe. **Competition is absent in the presence of a duopoly. (2)** Even if investments in the mobile telephony are smaller than those in fixed telephony, the services in the mobile network have much higher prices. **High termination tariffs in mobile networks discourage competition**, and on a medium term, prevent small companies from growing. In this direction, the mobile telephony tariffs should be put on costs. Also, until this is attained, the tariffs for termination in mobile networks should be equal with those from the fixed network: **€cents2.55/minute, instead of US\$ 0.10**, as it is now. **(3) CosmoRom needs a strategic partner**, one with at least regional ambitions, to rapidly construct a new business model; otherwise we will make the Guinness Book of Records with the first bankruptcy of a GSM operator.
- In the process of adopting EU laws in telecommunications, these should be **adapted to the national context, too** – the macroeconomic and telecommunication ones. **(1) The Universal service was applied by prosperous nations** to help minority groups (very few of citizens!) while in Romania poverty is a mass phenomenon. Also, the amount proposed for financing the Universal Service (1% of the turnover) is insufficient for Romania's needs and it should not be taken from an industry which, despite of its evolution much over the national economy, was not able to keep the pace with the rest of Europe. Excessive regulations imposed by the law can make its implementation difficult. **(2)** 20 years ago, when no alternative was available, **the access to the local loop of the incumbents was meant to spur competition**. Today even the promoters of LLU are reconsidering their position. LLU did not lead to competition even in the presence of a strong infrastructure - 52%, the average of EU penetration rate. Romania's penetration rate is at 20%, thus the newly entered on the market do not have much to access. The rigorous implementation of the LLU law in Romania can misdirect investment from increasing penetration.
- For **increasing penetration in rural areas** other funding sources must be attracted, such as: **(1) Funding from telecommunications** resulted after: awarding the **3G licenses** (approx. US\$140m), **selling shares** of RomTelecom (IPO!), Radiocomunicații, POSTelecom, or Telecomunicații CFR and Teletrans (over US\$500m), taxes raised (frequencies usage, etc.), or privatizing the operators Radiocomunicații, Telecomunicații CFR, Teletrans by **raising their share capital; (2) Funds from the state budget; (3) Funding from the European Union** through ISPA, SAPARD, PHARE or other specific programs for rural areas.
- It is also necessary to **raise the competitiveness of state companies** Radiocomunicații, POSTelecom, or Telecomunicații CFR and Teletrans, namely (1) emergency **privatization** through attracting a strategic partner and investment funds, and (2) **privatization through raising the share capital**.

Authors and contributors

This report is brought to you by the following experts and collaborators of the Romanian Academic Society:

Politics:

Alina Mungiu Pippidi, SAR president

Local governments reform:

Sorin Ioniță, SAR executive director

Economy:

Nicolae Oacă, senior telecom analyst

Issue editor, Layout:

Csilla Kajtar

Researchers:

Laura Simionescu, Sorana Pârvulescu

Romanian Academic Society (SAR)
15 Petőfi Sándor
Bucharest 1, Romania
++4021-2221868
office@sar.org.ro